AFTERMATH OF BROWN SHOE

Reynolds Metals Inc. v. Federal Trade Commission
309 F.2d 223 (D.C.Cir. 1962)

In 1956, Reynolds Metals, world's largest producer of aluminum foil, acquired Arrow Brands, Inc., a company which specializes in converting jumbo rolls of raw foil into smaller quantities of decorated foil which is sold almost exclusively to the florist trade. Although Arrow was one of 200 converters, only eight of these dealt with florist foil.

The Federal Trade Commission ordered Reynolds to divest itself of its new acquisition because the merger violated section 7 of the Clayton Act.[1] Reynolds appealed from this order on three grounds; (1) the production and sale of decorative aluminum foil to the florist trade is not the relevant line of commerce, (2) the acquisition does not violate the precepts of section 7, and (3) the order requiring Reynolds to divest itself of after-acquired-property is a taking without due process within the meaning of the fifth amendment. The court decided against Reynolds on the first two points, but agreed that the divestiture need not be ordered. The court was concerned primarily with the relevant line of commerce. Utilizing the criteria set forth in *Brown Shoe v. U.S.*,[2] the court agreed with the FTC that the line of commerce was decorative foil used in the florist trade.

The instant case then arose under section 7 of the Clayton Act which was enacted by Congress in 1914 to supplement the Sherman Anti-trust Act of 1890,[3] by permitting regulation of business activities before a violation of the Sherman Act occurred, and monopoly became a fact. Section 7, however, was ineffective in attaining this object. By its terms and later judicial interpretation, it covered only stock acquisitions where competition was reduced between corporations.[4] Thus to enjoin the acquisition of assets, the government would have the burden of proving that such a merger would violate the stricter precepts of the Sherman Act. As a consequence, many industries became highly concentrated, particularly after World War II.[5]

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1 64 Stat. 1125 (1925), 15 U.S.C. 18 (1958).

> No corporation engaged in commerce shall acquire . . . the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly. . . .

2 Brown Shoe v. U.S., 370 U.S. 294 (1962).

3 26 Stat. 209 (1890), 15 U.S.C. 2 (1958).

4 Arrow-Hart and Hegeman Electric Co. v. FTC, 291 U.S. 587 (1934); International Shoe Co. v. FTC, 280 U.S. 291 (1930).

5 Houghton, "Revelations and Paradoxes of Recent Anti-trust Decisions," 7 Anti-Trust Bull. 733, 736 (1963).

Congress closed this loophole in 1950, proscribing all mergers where the tendency would be to lessen competition in any line of commerce.[6]

In the ten years following amendment, some 89 suits were filed, and some 30 have been adjudicated.[7] All deal with the three problems of relevant geographic market, relevant line of commerce, or product market, the tendency to lessen competition, or control the market. The courts have uniformly declined to lay down any definite rules as to what the government must prove in each of these three categories, preferring a more flexible standard. Under sections 1 and 2 of the Sherman Act and section 3 of the Clayton Act, proving the existence of certain conduct such as price-fixing may be sufficient for injunction, regardless of the business purposes behind the conduct in question. In a section 7 case, however, economic data becomes extremely important to proving or disproving violation, as does past history of merger, and economic condition of the industry. Merger is not a per se violation.

For example, although both Reynolds and the FTC agreed in the instant case that the geographic area under consideration was the entire United States, in many other cases this question has been hotly contested. The court has in each case looked to the facts and the effect of the merger in particular areas to determine the relevant geographic market. In *Crown-Zellerbach v. F.T.C.*,[8] a paper manufacturer argued that the effect of the merger should be judged over the whole United States west of the Mississippi, the FTC argued for an eleven state area, but the court decided on a three state area. Determination turned on distribution facilities of the two companies, location of customers, and line up of the industry as a whole. In the recent bank merger case,[9] the Supreme Court held, *inter alia,* that the four county area surrounding Philadelphia was the relevant geographic market. The banks had argued that they competed for business in the entire northeastern United States, but the court, relying on *Tampa Electric Co. v. Nashville Coal Co.*[10] felt that the test should be the area in which the seller operates and to which the purchaser can practicably turn for supplies. Here the four county area was used by a Pennsylvania statute to limit branching, and deliniated the area in which the average customer would bank.

Although the determination of geographic market has given the courts some pause, much more litigation has developed over deliniation of the relevant line of commerce. The tests used in determining line of commerce under the Clayton Act and relevant market under the Sherman Act were different in the past, but are now essentially the same.[11] However, in de-

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[6] Similar legislation had been proposed before; the decision in U.S. v. Columbia Steel Co., 334 U.S. 495 (1948), apparently provided the necessary impetus for final enactment.

[7] Phillips and Hall, "Merger Litigation, 1951-1960," 6 Anti-Trust Bull. 19 (1961).

[8] 296 F.2d 800 (9th Cir. 1961).

[9] U.S. v. Philadelphia National Bank, 83 Sup. Ct. 1715 (1963).

[10] 365 U.S. 320 (1961).

[11] "Determination of relevant market is a necessary predicate to a finding of violation of the Clayton Act." U.S. v. DuPont, 353 U.S. 586, 193 (1957). The "legal test governing product market definition is essentially the same under the Sherman and Clayton Acts." Handler and Robinson, "A Decade of Administration of the Celler-Kefauver Anti-Merger Act," 61 Colum L Rev 629, 643 (1961).

termining relevant line of commerce, courts have relied on definitions derived in Sherman Act cases as to what constitutes relevant market and vice versa.

In *U.S. v. DuPont* (the cellophane case),[12] the criteria was determined to be reasonable interchangeability with other products, based on cross-elasticities of demand, or "how far buyers will go to substitute one commodity for another."[13] It was shown that buyers were quite willing to shift from cellophane to other flexible packaging materials as price fluctuated.

In the next year, in deciding an old section 7 case,[14] the Supreme Court did not mention the criteria of the cellophane case, but determined that automotive finishes had such "peculiar characteristics and uses"[15] to make them a line of commerce within the meaning of the Clayton Act. *International Boxing Club of N.Y., Inc. v. U.S.,*[16] a section 2 case, cited both of the latter cases and stated that championship boxing was analogous to the peculiar characteristics of auto fabrics and finishes which would bring it within the Clayton Act line of commerce.[17] In *U.S. v. Columbia Pictures Corp.,*[18] the line of commerce was found to be all forms of television programming material, and reasonable interchangeability was equated with lack of peculiar characteristics and uses. In *American Crystal Sugar v. Cuban American Sugar Co.,*[19] cane and beet sugars, although of different prices, were considered to be part of one market because of the high degree of interchangeability. However, in *U.S. v. Bethlehem Steel Corp.,*[20] a section 7 case, it was noted that "there can be a substantial lessening of competition with respect to a product whether or not there are reasonable interchangeable substitutes."[21] Nonetheless it has been argued that if a product has sufficiently peculiar characteristics and uses to be a distinct line of commerce, it is not reasonably interchangeable with other products.[22]

The Supreme Court in the only post-1950 merger case, *Brown Shoe,*[23] was inclined to agree with the *Bethlehem Steel* court. It felt that while the concepts of cross-elasticities of demand and reasonable interchangeability might mark the outer limits of a general market, sub-markets may exist which are important for anti-trust purposes.

> Boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the products peculiar charac-

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12 351 U.S. 377 (1956).

13 *Ibid.* at 393. This approach was first developed in Times-Picayune Publishing Co. v. U.S., 345 U.S. 594 (1953), a Sherman Act case.

14 U.S. v. DuPont, 353 U.S. 586 (1957), the General Motors Case.

15 *Id.* at 593.

16 358 U.S. 242 (1959).

17 *Id.* at 252 n. 8.

18 Trade Reg. Rep. (1960 Trade Cas.) 69766 (S.D.N.Y. July 1, 1960).

19 259 F.2d 524 (2d Cir 1958).

20 168 F. Supp. 576 (S.D.N.Y. 1958).

21 *Id.* at 593, n. 36.

22 Handler and Robinson, *supra* note 11 at 647-48.

23 *Supra* note 2.

> teristics and uses, unique production facilities, distinct customers, distinct prices. . . .[24]

Using this indicia the Supreme Court found the relevant markets to be men's, women's and children's shoes.[25]

Similarly, by looking at "industry or public recognition of the submarket as a separate economic entity," "distinct customers," and "distinct prices," the court in the instant case found the relevant line of commerce to be aluminum foil used in the florist trade. Only eight converters sold to the some 700 wholesale outlets and only these outlets purchased from the eight. Furthermore, the price of florist foil was significantly lower ($.75-.85 per unit) than other decorative foil ($1.15-1.22). The court felt that no prudent business man would pay a higher price if the submarket were not a distinct entity. Thus the relevant line of commerce was florist foil.

The second issue was whether the acquisition of Arrow would tend to substantially lessen competion in the florist trade. Again the problem was one of standards, or tests for measuring legality. Since the language of section 7 is virtually that of section 3 of the Clayton Act,[26] it had been thought that Congress intended that the same judicially determined tests for illegality under that section were to be used for determining a section 7 violation. The test at that time (1950) was one of quantitative substantiality developed by Mr. Justice Frankfurter in the *Standard Stations* case.[27] However, the FTC rejected the test for section 7 cases at an early date, and stated that each case would have to be determined by itself, using economic and historical data.[28]

Since then each case has relied on a variety of factors in addition to percentage of the market,[29] such as case of entry,[30] tendency of the industry towards concentration,[31] availability of alternate sources of supply for the buyer,[32] or conversely, retail or wholesale outlets for the manufacturer,[33] the position of the industry after the merger, and the probable future of the industry.[34]

Although the court does not discuss the point it is perhaps important that this was a vertical merger. Until the *Brown Shoe* case, most adjudi-

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24 *Id.* at 325.

25 While the government argued against dividing the relevant market into higher and lower priced shoes in *Brown,* in AG Spalding Brothers Inc. v. FTC 301 F.2d 585 (3d Cir. 1962), it succeeded in arguing for such a deliniation in various lines of sporting goods.

26 15 U.S.C. 14 (1958).

27 Standard Oil v. U.S., 337 U.S. 293 (1949). The phrase means that if exclusive dealing agreements embrace a substantial share of the market (6.7%), the court need not inquire into domination or effect on competition. This rigid standard appears to have become more flexible however, *cf.* Tampa Electric, *supra* note 10.

28 Pillsbury Mill Inc., 50 FTC 555 (1953).

29 *AG Spalding, supra* note 25; *Crown Zellerback, supra* note 8.

30 *Id,; American Crystal Sugar, supra* note 19, *Bethlehem Steel, supra* note 20.

31 *AG Spalding, ibid.*; *Bethlehem Steel, ibid.*

32 *Crown Zellerbach, supra* note 8; *Bethlehem Steel, ibid.*

33 *AG Spalding, supra* note 25.

34 *Brown Shoe, supra* note 2.

cated mergers had been horizontal,[35] that is a merger among retailers or wholesalers, or manufacturers. Although *Brown Shoe* had horizontal aspects, it was the vertical aspect, that is the merger of two manufacturers with retail outlets, which posed the greatest threat to competition in an industry characterized by such a tendency to integrate. The implications of that case, moreover, seem to proscribe vertical mergers involving leaders of an industry.

At any rate, Arrow being one of eight converters and having 33% of the market before acquisition is now acquired by what the court calls "a rich parent" with a "deep pocket." It noted that although Reynolds' competition lost 33% of the florist foil trade because of the removal of Arrow, the more important anti-competitive effect would be felt by Arrow's competitors. Having a rich parent, Arrow was in a position to cut prices below cost to its competitors.

The court noted that all that need be shown was the capacity to cut prices, or potentiality of lessened competition, and not that this effect had actually been achieved. The court did observe however, that the sales of five of Arrow's competitors had dropped from 14% to 47% below 1955 sales in two years. Meanwhile, Arrow's sales had increased 18.9%. Thus the potentiality was somewhat realized.

The court agreed that Reynolds and Arrow would have to be divorced, yet it also felt that the Commission did not have the power to require that Reynolds divest itself of a new plant it had built for Arrow, and the fixtures therein. It did not reach the question of whether this would be a taking without due process within the meaning of the fifth amendment, and left open the question of whether in a case of dire necessity such a divestiture of after-acquired-property would be warranted. Here, there was no such necessity; competition could be restored without invoking such a harsh remedy.

Thus the court by applying *Brown Shoe's* list of criteria for determining relevant submarkets, in a mechanical fashion concluded in short order that decorative foil used in the florist trade was the relevant line of commerce. Having done this, its problem of determining whether competition would be lessened became simple, due to Arrow's large share of the market. Although there will always be factual problems in determining line of commerce or submarket involved, *Brown Shoe* does lay down helpful guidelines for weighing various economic factors in a section 7 case.

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35 The notable exception being *DuPont, supra* note 14.